APPENDIX 5: DR. HALLMAN IGNORES INCONSISTENT ANALYST COMMENTARY WITH RESPECT TO EACH OF THE FOUR ANALYZED DATES THAT YIELDED STATISTICALLY INSIGNIFICANT RESULTS.

1. Dr. Hallman concludes that Freddie Mac's stock price "reacted" in the "logical direction" on 4 of the 6 Analyzed Dates even though Freddie Mac's abnormal returns were not statistically significant with p-values at or below 5% on these dates.

2. Having first incorrectly assigned a "direction" to Freddie Mac's statistically insignificant abnormal return on 4 of the 6 Analyzed Dates, Dr. Hallman then claims that the "direction" of Freddie Mac's price change was "logical", *i.e.*, the abnormal return was positive following unexpected positive news and negative following unexpected negative news.

3. A review of information releases on these 4 Analyzed Dates demonstrates that Dr. Hallman has selectively cited news and analyst commentary and ignored evidence to the contrary to support his conclusion. Dr. Hallman's methodology is therefore unscientific because it can be tailored to reach any desired conclusion.

A. October 3, 2006 — Dr. Hallman's claim that Freddie Mac's positive (but not statistically significant) abnormal return was "logical" ignores contemporaneous, negative information.

4. Dr. Hallman claims that the 1.2% abnormal return on October 3, 2006, though not statistically significant, was "logical" because it was consistent with what he describes as unexpected and positive analyst commentary on that day by Prudential Equity.[1] In support of his interpretation, he quotes some parts of the report: "earnings surpass expectations"; "stable outlook"; and "better-than-expected credit losses".

5. Dr. Hallman fails to acknowledge, however, that the report by Prudential Equity was not uniformly positive. Rather, it contained a number of negative comments and warned of potential future problems for investors in Freddie Mac. Even the title of

[1] Park, Matthew, "FRE: 1H06 Earnings – GAAP Earnings Surpass Our Expectations Due To Higher Rates In 2q (Since Reversed); Stable Outlook On Credit And Interest Rate Risks," *Prudential Equity Group LLC*, October 3, 2006.

the report highlighted the fact that Freddie Mac's earnings for the first half of 2006 were due to higher interest rates which had "**since reversed**."[2] This obviously meant that the Prudential Equity analysts expected Freddie Mac's future earnings to decline. Further, those analysts set a target for Freddie Mac's stock price that was "below the historical average," which they noted was "warranted given residual uncertainties about regulatory reform and higher anticipated short-term earnings volatility due to increased mark-to-market components of earnings."[3]

6. Not only did Dr. Hallman ignore the negative portions of the report he cited, he neglected other contemporaneous analyst commentary that I have uncovered with my own research. That commentary was unfavorable regarding the financial health and future of Freddie Mac. On the same day of the Freddie Mac press release and the Prudential Equity report, J.P. Morgan analysts offered a negative opinion with this strong warning: "[w]e believe a significant piece of [Freddie Mac's estimated net income of $2.7 billion in the first half of 2006] likely came from the mark-to-market gains, which have likely reversed in 3Q and **should drive a steep decline in earnings in 2H06 unless interest rates rise**."[4] A similarly negative view came in a *Dow Jones Newswire* report: "[g]iven the reversal of interest rates … since June 30, management expects to report **a significant reversal** of these mark-to-market gains in the company's third quarter results."[5]

7. Dr. Hallman's assertion that the stock's reaction was in the "logical" direction is an instance of the *post hoc* fallacy, because it is based on his selective review of news and commentary *ex post* that is consistent with his identified "direction" of Freddie Mac's price change.

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2 Park, Matthew, "FRE: 1H06 Earnings – GAAP Earnings Surpass Our Expectations Due To Higher Rates In 2q (Since Reversed); Stable Outlook On Credit And Interest Rate Risks," *Prudential Equity Group LLC*, October 3, 2006.

3 Park, Matthew, "FRE: 1H06 Earnings – GAAP Earnings Surpass Our Expectations Due To Higher Rates In 2q (Since Reversed); Stable Outlook On Credit And Interest Rate Risks," *Prudential Equity Group LLC*, October 3, 2006.

4 Sacco Jr., George A. and Marco E Villegas, "Freddie Mac--1H Returns Boosted by Mark-to-Market Gains; Expect Sharply Lower Earnings in 2H06," *J.P. Morgan*, October 4, 2006. [Emphasis added]

5 "Freddie Mac Provides Market Update," *Dow Jones News Service*, October 3, 2006. [Emphasis added]

8. As I have noted, my own research into the contemporaneous economic evidence reveals that there was negative commentary by analysts on this day, which Dr. Hallman ignores. Dr. Hallman provides no explanation about how he selected certain analyst commentary as relevant while ignoring others. This methodology of course produces results that are not replicable. Most importantly, this sifting of evidence can be tailored to reach any desired conclusion.

9. Accordingly, one could – by ignoring the positive commentary (which Dr. Hallman selectively identifies) and selectively identifying only the negative commentary (which was present on this date as I have demonstrated) – equally well "show" that Freddie Mac's positive (but not statistically significant) abnormal return on this date was <u>not</u> in the logical direction. Conversely, if Freddie Mac's abnormal return were negative (but not statistically significant), then an emphasis on negative commentary and concealment of the positive commentary could support the view that the negative price reaction was actually logical.

10. As I explain below, Dr. Hallman applies this flawed analysis on three other Analyzed Dates. On each of these dates, he again selectively cites some news and commentary that was consistent with the "direction" he assigns to Freddie Mac's (statistically insignificant) abnormal return, while ignoring news and commentary that would lead to the opposite conclusion.

B. January 5, 2007 — Dr. Hallman's claim that Freddie Mac's negative (but not statistically significant) abnormal return was "logical" ignores contemporaneous, positive information.

11. Dr. Hallman claims that this day's -1.0% abnormal return, though not statistically significant, was "logical" because it was consistent with what he views as unexpected, negative forecasts in Freddie Mac's "Market Update" on that day, as well as unfavorable commentary by analysts on the Update. (Dr. Hallman claims that the news versus expectation was "weakly negative",[6] without explaining the difference, if any, between a price reaction that is negative versus one that is "weakly negative".)

6 Hallman Report, Table 1.

In making this claim, Dr. Hallman ignores information releases on this date that are positive and, therefore, would refute his conclusion.

12. In my research into the news and analyst commentary around this date, I found information that was positive for the future prospects of Freddie Mac stock. I note, first, that the Freddie Mac Update itself contained some favorable information that Dr. Hallman does not cite: its estimated net income for the first nine months of 2006 ($2.5 billion) was nearly double its net income for the first nine months of 2005 ($1.4 billion). In the analysts' commentary, I found that Bear Stearns "continue[d] to expect that the company's business can generate increases in the fair value of common equity of 12% to 17% over time, although the company's current disclosures (until year end) make it difficult to accurately gauge."[7] These analysts also noted that (i) the Company had "a substantial excess capital position, even after the completion of the previously announced $2 billion common share repurchase program"; and (ii) its GAAP losses were due to "gains recognized during the first half of the year [which] were reversed."[8]

13. In addition, Prudential Equity analysts at the time believed that Freddie Mac "shares offer an attractive risk-reward tradeoff as the political and regulatory risks diminish and as the GSEs should benefit from the continued industry mix shift away from non-traditional mortgages."[9] These analysts also stated that the Company's "underlying financial performance remains relatively stable in 3Q06 despite high quarterly volatility in GAAP net income and lack of more detailed financial data."[10] Even the *New York Times* article which Dr. Hallman cites in paragraph 22 of his report

7 Hochstim, David, "Freddie Mac (FRE-$67.93-Peer Perform) Q3 Update Includes Reiteration of Return to Timely Reporting in 2H 07," *Bear Stearns*, January 5, 2007.

8 Hochstim, David, "Freddie Mac (FRE-$67.93-Peer Perform) Q3 Update Includes Reiteration of Return to Timely Reporting in 2H 07," *Bear Stearns*, January 5, 2007.

9 Park, Matthew, "FRE: Quicktake On 3q06 Earnings – GAAP Net Loss Due To Rate Movements But Underlying Economics Appear To Be Relatively Stable; Slower Progress On Timely Reporting And Capital Mgmt," *Prudential Equity Group LLC*, January 5, 2007.

10 Park, Matthew, "FRE: Quicktake On 3q06 Earnings – GAAP Net Loss Due To Rate Movements But Underlying Economics Appear To Be Relatively Stable; Slower Progress On Timely Reporting And Capital Mgmt," *Prudential Equity Group LLC*, January 5, 2007.

recognized that Freddie Mac's third quarter 2006 loss of $550 million was "in line with analysts' expectations."[11]

14. The next example of Dr. Hallman's inconsistent interpretation of news on the dates he analyzed is complicated but interesting. As I note above, Dr. Hallman ignores negative commentary by several analysts on October 3, 2006 who had earlier predicted that Freddie Mac's earnings would decline in the second half of 2006 if market interest rates would fall over that period, as they actually did. Yet, regarding January 5, 2007, Dr. Hallman claims that nearly identical negative analyst commentary (about Freddie Mac's expected future losses in the fourth quarter of 2006 due to declining interest rates) constitutes "unexpected negative news" that "logically" explains Freddie Mac stock's -1% abnormal return on January 5, 2007.[12] (I note that Freddie Mac's January 5, 2007 press release made clear that its expected loss in the fourth quarter of 2006, which Dr. Hallman considered negative news, was due to the same "changes in the interest rate environment" that constituted the "primary reason" for its third quarter 2006 GAAP net loss.)[13] Such an *ad hoc* and contradictory treatment of the same type of economic news highlights the unscientific nature of Dr. Hallman's analysis, which is not consistent with well-accepted economic principles and professional standards.

15. Clearly, Dr. Hallman's view that the adverse effect of declining interest rates on Freddie Mac's expected future earnings did not constitute "news" on October 3, 2006, but was relevant news several months later (on January 5, 2007) highlights Dr. Hallman's arbitrary interpretation of Freddie Mac's stock price movements. Most economists expect a stock's price to react similarly to similar news items on different days if the stock trades in an efficient market. They do not expect, as Dr. Hallman apparently does, the price to be unmoved by a news item one day and yet react to virtually the same kind of report when it appears three months later.

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11 "Today In Business Freddie Mac Forecasts Losses," *The New York Times*, January 6, 2007 [Cited in Hallman Report, ¶ 22].

12 Hallman Report, ¶22.

13 "FRE - Freddie Mac Market Update," *Thomson StreetEvents*, January 05, 2007.

C. March 23, 2007 — Dr. Hallman's claim that Freddie Mac's positive (but not statistically significant) abnormal return was "logical" ignores contemporaneous, negative information.

16. Freddie Mac reported its full-year 2006 financial results on March 23, 2007, following which the stock's abnormal return, according to Dr. Hallman event study model, was +0.2%, and not statistically significant. Dr. Hallman does not assign a direction to this abnormal return, as he did on three other dates when the stock's abnormal returns were also not statistically significant. Instead, he categorizes the stock price reaction on this date as a "muted stock price reaction."[14] He does not explain as to why there is no logical direction on March 23, 2007, thus failing to provide any objective and replicable criteria to support his *ad hoc* treatment of these dates.

17. Dr. Hallman's conclusion on this date is again based on a selective treatment of contemporaneous news and analyst commentary. He claims that Freddie Mac's "muted stock price reaction" on March 23, 2007 was a result of earnings that were "in line with expectations,"[15] according to analysts he cites. In so doing, he ignores the negative opinions expressed by several other analysts which my research has uncovered. For instance, Credit Suisse analysts considered Freddie Mac's results "weak."[16] These analysts noted that Freddie Mac's "overall fair value returns of 9.5% remain below Freddie's targeted return threshold. Fair value results remain suppressed as its portfolio margin is under pressure" and that the "current business environment remains challenging for Freddie Mac."[17] In addition, a Fox-Pitt, Kelton analyst noted that Freddie Mac's fair value ROE had "missed 2 years in a row."[18] These analysts note that the Company's reported "fair value equity return at 9.5%, up from 3.7% in 2005 [was] still well below its low to mid-teens target (13–15% FPKe).

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14 Hallman Report, ¶23.

15 Hallman Report, Table 1.

16 Orenbuch, Mosche and Kerry Hueston, "Freddie Mac (FRE) EARNINGS—2006 Results Weak; No Timeline Given for 2007 Reporting Schedule," *Credit Suisse*, March 23, 2007.

17 Orenbuch, Mosche and Kerry Hueston, "Freddie Mac (FRE) EARNINGS—2006 Results Weak; No Timeline Given for 2007 Reporting Schedule," *Credit Suisse*, March 23, 2007.

18 Groshans, Edwin, "Freddie Mac—Buybacks Bolster Lackluster Results," *Fox-Pitt*, *Kelton*, March 23, 2007.

Given the expected margin pressure combined with wider credit spreads, it seems unlikely that FRE will hit the low end of its target in 2007."[19]

18. In short, once again, Dr. Hallman presents an *ad hoc* and unscientific analysis and ignores economic evidence that is inconsistent with his conclusions.

D. June 14, 2007 — Dr. Hallman's claim that Freddie Mac's negative (but not statistically significant) abnormal return was "logical" ignores contemporaneous, positive information.

19. Freddie Mac reported its First Quarter 2007 financial results on June 14, 2007, following which the stock's abnormal return, according to Dr. Hallman event study model, was -1.3% and not statistically significant. Although Dr. Hallman claims that this abnormal return was in the "logical direction," given contemporaneous unexpected news, he offers no independent review of analyst commentary to assess what, if any, unexpected negative news was released that day. Instead, Dr. Hallman cites **only** a *Reuters* article that refers to negative commentary by some **unnamed** analysts.[20]

20. In contrast, my research into contemporaneous news and commentary confirms that several analysts opined that Freddie Mac's earnings release on this date was either as expected or positive. For instance, according to a J.P. Morgan report, Freddie Mac's loss for the first quarter of 2007 was due to its "mark-to-market losses on derivatives and the guarantee asset," which only "muddied" the Company's otherwise "in line" performance. The report noted that Freddie Mac's "underlying business trends were **favorable** as highlighted by strong growth of guarantee fees, stable net interest margin, and continued low credit losses."[21]

21. In addition, Bear Stearns analysts at the time also noted that a substantial portion of the Company's "mark-to-market adjustments to derivatives" (which had resulted in

[19] Groshans, Edwin, "Freddie Mac—Buybacks Bolster Lackluster Results," *Fox-Pitt, Kelton*, March 23, 2007.

[20] Hallman Report, ¶24.

[21] Sacco Jr., George A. and Marco E Villegas, "Mark-to-Market Items Muddy Otherwise In-line Quarter," *J.P. Morgan*, June 14, 2007. [Emphasis added]

its first quarter 2007 loss) may be "**reverse[d]** in subsequent periods."[22] In further commentary, Standard & Poor's noted that:[23]

> Offsetting the [Company's] GAAP-reported loss was net interest margin stability during the first quarter and **strong credit performance metrics**, as net charge-offs were 1.5 basis points and **mortgage portfolio growth was strong**. Also, the low level of portfolio market value sensitivity and quarterly financial reporting are **evidence that interest rate risk management practices have been effective.**

22. In summary, Dr. Hallman's claim that Freddie Mac's stock displayed a cause-and-effect relationship to news on these four Analyzed Dates is based on news and analyst commentary that he selectively identifies. Such a selective identification is unscientific and can be tailored to reach any conclusion that Dr. Hallman would like to make.

[22] Hochstim, David, et al., "Freddie Mac Releases 1Q07 Results, Resumes Quarterly Reporting," *Bear Stearns*, June 14, 2007. [Emphasis added]

[23] "McGraw Hill Companies Inc. - Freddie Mac Rating Not Affected By First-Quarter Loss," *Market News Publishing*, June 14, 2007. [Emphasis added]